

facilities provider. For all competitors in the Phoenix MSA other than U S WEST, the retail service provider can take advantage of its relationship with the customer to offer a full service package which includes interLATA voice and data services.

The Commission has acknowledged the fact that competitive entry of resellers, some of which may grow to become regional or even national facilities-based competitors, puts downward pressure on prices.⁵⁵ In its recent decision denying Personal Communications Industry Association's petition for forbearance from enforcing the resale rule as applied to PCS providers, the Commission stated that resellers exert downward pressure on rates through their ability to purchase services at high volume rates and pass through those savings to their customers.⁵⁶ The Commission also noted that resellers are able to offer their customers packages of services, some or all of which may be obtained from other providers, thereby enabling resellers to tailor service packages to meet each customer's particular mix of needs.⁵⁷ As discussed above, resellers of high capacity services enjoy a significant competitive advantage over U S WEST because of their ability to offer a full service package that includes interLATA services.

Moreover, expansion of competitive providers' business has been even more rapid than the impressive 13 percent growth in the demand for high capacity

⁵⁵ AT&T Reclassification Order at 3304 ¶ 61; In the Matter of Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance for Broadband Personal Communications Services, Memorandum Opinion and Order and Notice of Proposed Rulemaking, FCC 98-134, ¶ 35, rel. July 2, 1998 ("PCIA Forbearance Order").

⁵⁶ Id.

⁵⁷ Id.

services in the Phoenix market.⁵⁸ During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the provider segment (i.e., high capacity services ultimately purchased by end users) increased from less than six percent to 28 percent.⁵⁹ The competitive providers' market share of the transport segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly, increasing from five percent to 16 percent between the second quarter and the fourth quarter of 1997 alone.⁶⁰ Perhaps the most significant trend statistic is the fact that, between the second and fourth quarters of 1997, competitive providers captured 54 percent of the growth in demand of the provider segment and 42 percent of the growth in demand of the transport segment.⁶¹ Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Phoenix MSA have captured a majority share of market growth over the past several years.⁶²

U S WEST's rapid reduction in market share is largely the result of facilities build-out on the part of competitive providers in the Phoenix area and their focus on the large business market. U S WEST's share of the facilities-provider market segment is likely to decrease rapidly as customers, particularly the largest carrier

⁵⁸ Attachment C, Kahn and Tardiff Paper at 7. With this rate of growth, demand for high capacity services will double in about 5 1/2 years.

⁵⁹ Attachment A, Quality Strategies Report at 16.

⁶⁰ Id. at 14.

⁶¹ Id. at 15.

⁶² Id. at 7.

customers, migrate traffic onto their own fiber networks.⁶³ As discussed above, U S WEST already is feeling the impact of this migration. Kahn and Tardiff also assert that the recent strong growth in competitive provider market share is likely to continue, and may even accelerate, given the rapid growth of competitive provider market share nationwide.⁶⁴ They note that, during the first quarter of 1998, competitive providers added more business lines nationwide than the Regional Bell Operating Companies ("RBOC").⁶⁵

Kahn and Tardiff compare the Phoenix area market share information with the situation the Commission considered when it granted AT&T non-dominant status for interstate long distance. While U S WEST's overall share of the Phoenix area market for high capacity services is higher than AT&T's share of the long distance market when the Commission found AT&T to be non-dominant (77 percent compared to 60 percent), U S WEST's market share of the retail segment is much lower than AT&T's.⁶⁶ According to Kahn and Tardiff, "we doubt there would be economists prepared to refer to a firm with 30 percent of the retail market as 'dominant.'"⁶⁷ Moreover, for both the retail and wholesale market segments, competitive providers' shares and volumes of the high capacity business in the

⁶³ Id. at 31.

⁶⁴ Attachment C, Kahn and Tardiff Paper at 7.

⁶⁵ Id. at 8 (citing Statement of Heather Gold, FCC En Banc on State of Local Competition, January 29, 1998 and Salomon Smith Barney "CLECs Surpass Bells in Net Business Line Additions for the First Time," May 6, 1998).

⁶⁶ Id.

⁶⁷ Id.

Phoenix area are growing at a considerably more rapid rate than were AT&T's competitors' shares and volumes of the long distance business.⁶⁸ In their study, Kahn and Tardiff's state that "the consensus of economic opinion would be to place greater emphasis on changes in market shares over time and shares in incremental business than their absolute levels."⁶⁹ Accordingly, their conclusion is that U S WEST has a much stronger case for claiming a lack of market power in the Phoenix area market for high capacity services than did AT&T.⁷⁰

3. Demand Elasticity

Demand elasticity refers to the willingness and ability of a carrier's customers to switch to a competitive provider, or to otherwise change the amount of services they purchase from the carrier in response to a change in the price or quality of the services. High demand elasticity indicates that customers are willing and able to switch to another service provider in order to obtain price reductions or desired features. It also indicates that the particular service market is subject to competition.⁷¹

In granting non-dominant status to AT&T, the Commission observed that the demands of business customers are highly elastic because they are sophisticated buyers who typically receive and consider alternative proposals from several

⁶⁸ Id.

⁶⁹ Id.

⁷⁰ Id. at 9.

⁷¹ Comsat Reclassification Order ¶ 71.

vendors.⁷² They also are likely to engage in long-term planning and ordering.⁷³ The Commission's observation with respect to long distance services clearly applies with at least as much force to the segment of the business customer market that purchases high capacity services and facilities – medium to large business customers, governmental entities and other carriers.⁷⁴

In support of their conclusion, Kahn and Tardiff reference the economic analysis prepared by Professor Michael Porter that AT&T submitted with its request for non-dominant status.⁷⁵ Porter found that business customers have considerable negotiating power because of their sophisticated knowledge of telecommunications, their use of outside network consultants, and their ability to provision their own network facilities. Kahn and Tardiff conclude that these factors “are even more powerful in the case of high capacity services” because of the fact that the primary users of these services – other carriers – have both the incentive and the ability to drive a hard bargain for good prices and levels of service by the threat of going elsewhere.⁷⁶ The ability of U S WEST's largest carrier customers to

⁷² AT&T Reclassification Order, 11 FCC Rcd. at 3306 ¶ 65.

⁷³ Comsat Reclassification Order ¶ 72.

⁷⁴ Attachment C, Kahn and Tardiff Paper at 9.

⁷⁵ Id. at 10 (citing Michael E. Porter, Competition in the Long-Distance Telecommunications Market, September 1993). Kahn and Tardiff note that the Commission cited the Porter Study when concluding that demand elasticity considerations supported the conclusion that AT&T was non-dominant in the long distance market. Id.

⁷⁶ Id.

migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability in the marketplace.

As Kahn and Tardiff note, these demand elasticity factors are further reinforced by the already high market share U S WEST's competitors have in the retail segment of the Phoenix area market for high capacity services and the rapid growth of the competitors' market share in the provider and transport segments of the market.⁷⁷ Given that the actual provider of the underlying high capacity facilities is often unknown to the end-user customer, U S WEST's retail competitors can take advantage of their customer relationships to become the customer's facilities provider and to acquire additional business.⁷⁸ Moreover, so long as U S WEST remains subject to the prohibition in offering interLATA services, the ability of competitive providers to offer a complete package of telecommunications services which includes interLATA voice and data services gives them a "great advantage" over U S WEST in the marketplace.⁷⁹

4. Supply Elasticity

Supply elasticity refers to the ability of suppliers in a given market to increase the quantity of services supplied in response to an increase in price. There are two factors that determine supply elasticities in the market. The first is the supply capacity of existing competitors, because supply elasticities tend to be high if existing competitors have or can easily acquire additional capacity in a relatively

⁷⁷ Id.

⁷⁸ Id.

⁷⁹ Id. at 11.

short time period.⁸⁰ The second factor is the existence of low barriers to entry, because supply elasticities tend to be high if new suppliers can enter the market relatively easily and add to existing capacity.

Quality Strategies has determined that U S WEST's competitors have more than sufficient readily available excess capacity to constrain U S WEST's pricing behavior. As a group, these five facilities-based competitors have installed more than 800 route miles of optical fiber in the Phoenix MSA, typically deploying cable consisting of 144 individual fiber elements along the network backbone.⁸¹ With current technology, these competitive fiber networks should be capable of transporting more traffic than the Phoenix area will ever generate. Indeed, equipped as they are today, the competitive fiber backbone networks could handle all of U S WEST's end-user and transport traffic at less than eight percent capacity.⁸²

The only real constraint on expanding service to U S WEST's customers in the near-term is the fact that competitive providers cannot provide service to "off-network" locations without building facilities to connect these sites to their fiber backbone networks. In most cases, this is not an issue at all. Approximately 65 percent of U S WEST's current high capacity demand in the Phoenix area is located within 100 feet of existing competitive provider fiber networks, which means that it

⁸⁰ Comsat Reclassification Order ¶ 78.

⁸¹ Attachment A, Quality Strategies Report at 6, 27. Attachment D hereto is a map illustrating the existing competitive provider fiber backbone networks in the Phoenix area.

⁸² Attachment A, Quality Strategies Report at 29.

is essentially located “on-network.” Thus, competitive providers could absorb a majority of U S WEST’s high capacity demand almost immediately, incurring only minimal costs.

Moreover, as the attached report prepared by PEI demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST’s current high capacity demand. Specifically, competitive providers in Phoenix can serve the almost 50 percent of U S WEST’s high capacity customer locations within 1,000 feet of their existing fiber networks – which accounts for approximately 86 percent of U S WEST’s current high capacity demand in the Phoenix area – if they invest \$45 million.⁸³ In addition, competitive providers can serve all of U S WEST’s high capacity customer locations within 9,000 feet of their existing fiber networks – which accounts for more than 95 percent of U S WEST’s current high capacity demand in the Phoenix area – if they invest approximately \$127 million.⁸⁴ As wireless technology continues to develop, high capacity fixed wireless alternatives will provide an alternative, low cost means of expanding these competitive fiber backbone networks.⁸⁵

To put these figures into prospective, Kahn and Tardiff observe that U S WEST’s current high capacity customers generate about \$50 million of revenue

⁸³ Attachment B, PEI Study at 3. Attachment E hereto is a map showing competitive provider coverage of U S WEST’s DS1 equivalent services, including a buffer area within 1,000 feet of existing competitive provider fiber networks.

⁸⁴ Attachment B, PEI Study at 3.

⁸⁵ Id.

annually in direct charges for high capacity facilities (i.e., for the “dial tone” alone).⁸⁶ This means that, based on plausible assumptions, the investment necessary to serve all that current business would be about 2.7 times revenues – a multiple “markedly lower” than U S WEST’s current investment to revenue multiple of 3.2 for Arizona.⁸⁷ The investment ratios required for competitive providers to reach those customers located within 1,000 feet of the providers’ existing fiber networks would be even more favorable.⁸⁸

The investment to revenue comparisons are somewhat hypothetical exercises for considering whether competitive providers would find it economical to expand their networks to serve U S WEST’s existing high capacity demand if it were to become available.⁸⁹ As such, the comparisons do not take into account the lost economies of scale and density that competitive providers would likely experience if they expand selectively to serve high volume/low cost locations.⁹⁰ On the other hand, Kahn and Tardiff state that focusing on scale economies sacrificed by targeting customers actually understates the attractiveness of serving current U S WEST high capacity locations, for two reasons.⁹¹ First, because the high capacity market is growing, competitive providers can realize economies of scale by

⁸⁶ Attachment C, Kahn and Tardiff Paper at 13.

⁸⁷ Id.

⁸⁸ Id.

⁸⁹ Id.

⁹⁰ Id.

⁹¹ Id. at 14.

serving the incremental demand in addition to demand captured from U S WEST.⁹² Second, it is important to recognize that the revenue figures only reflect payments for the use of the high capacity facilities – as such, they do not take into account the fact that competition increasingly involves the provision of a package of services (i.e., one-stop shopping).⁹³ Competitive providers that obtain access to a customer through their high capacity business have a vehicle for obtaining access to other higher margin services. This means that competitors may be willing to underprice their high capacity services in order to “capture” the customer. Taking the net revenues from bundled services into account would make the investment to revenue comparisons “markedly more favorable” according to Kahn and Tardiff.⁹⁴

Another important consideration in assessing supply elasticity is the timeliness with which current competitors can expand facilities to meet new demand. PEI estimates that competitive providers can serve the 50 percent of current U S WEST-served locations that are within 1,000 feet of the providers’ existing fiber networks in 18 to 24 months.⁹⁵ Kahn and Tardiff find that this time frame is “very significant” and consistent with the time frame envisioned in the Merger Guidelines for determining whether prospective new investments should be counted as a competitive presence disciplining the pricing behavior of firms

⁹² Id.

⁹³ Id. For example, ELI’s President and Chief Operating Officer Dave Sharkey stated in a news release dated May 4, 1998: “We are witnessing the success of our bundled service strategy, as nearly 60% of our customers purchased multiple products and services.” PR Newswire Association, Inc., May 4, 1998.

⁹⁴ Attachment C, Kahn and Tardiff Paper at 14.

contemplating a merger.⁹⁶ Although serving those customers beyond 1,000 feet would require additional time, the competitive providers' ability to do so is "competitively significant" according to Kahn and Tardiff.⁹⁷

The impressive growth of competitive provider's market share in the Phoenix area market for high capacity services demonstrates that the cost of entry is not prohibitive.⁹⁸ This growth is reflected in tremendous growth in the number and size of competitive providers nationwide. In addition, competitive providers have been attractive takeover targets and are having no trouble attracting large amounts of capital in the financial market. For example, ELI went public in November 1997 and raised \$128 million in its equity offering.⁹⁹ Kahn and Tardiff note that, in the two years since the passage of the 1996 Act, competitive providers have raised \$14 billion of outside capital, whereas total annual investment by incumbent LECs has been about \$18 billion.¹⁰⁰

Nor are there legal barriers to entry.¹⁰¹ Competitive providers have other market entry options in those areas where they choose not to deploy facilities. With the adoption of the 1996 Act, Congress implemented a comprehensive system of

⁹⁵ Attachment B, PEI Study at 3.

⁹⁶ Attachment C, Kahn and Tardiff Paper at 14-15

⁹⁷ Id. at 15.

⁹⁸ Id.

⁹⁹ ELI also has a \$400 million credit line, guaranteed by its parent company, Citizen's Utilities, which has an A+ rating with Standard & Poors. Citizen's other securities carry ratings that range from AA- to AA+.

¹⁰⁰ Attachment C, Kahn and Tardiff Paper at 16-17.

¹⁰¹ Compare Comsat Reclassification Order at ¶ 82.

market-opening provisions that benefit both facilities-based carriers and pure resellers. This flexibility allows competitive providers to increase their market presence through resale beyond the reach of their existing fiber networks. It also allows them to increase their market share more quickly than would be possible solely through expansion of their own networks.

5. U S WEST's Cost, Structure, Size and Resources

In the AT&T Reclassification Order, the Commission addressed the question of whether AT&T's size relative to other carriers might give it a significant advantage in terms of scale economies and access to capital.¹⁰² U S WEST does not enjoy any such advantage in the Phoenix area market for high capacity services. While the Commission considered the fact that AT&T faced at least two "full-fledged facilities-based competitors" in the long distance market,¹⁰³ U S WEST faces five established facilities-based competitors in the Phoenix MSA. As discussed above, the combined AT&T/TCG and MCI/MFS WorldCom entities have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services.

According to the Kahn and Tardiff Paper, the continued feasibility and vitality of competitive entry in the Phoenix area market for high capacity services is shown by the fact that the rapid expansion of competitive entry has occurred at the

¹⁰² AT&T Reclassification Order, 11 FCC Rcd. at 3309 ¶ 73. The Commission recently held that Comsat does not have market power, notwithstanding its finding that Comsat has competitive advantages in size and access to resources. Comsat Reclassification Order ¶ 93.

¹⁰³ AT&T Reclassification Order, 11 FCC Rcd. at 3308 ¶ 70.

same time as incumbent charges for high capacity services have substantially declined.¹⁰⁴ In fact, when the first competitive providers entered the high capacity services market in the late-1980s, prices for high capacity services were approximately twice their current levels.¹⁰⁵ The fact that competitive activity in the market is accelerating while prices for services are dropping is a strong indication that investors do not believe incumbents have an insurmountable cost advantage in the market.¹⁰⁶

C. U S WEST Lacks The Ability To Exercise Market Power
In The Phoenix Market For High Capacity Services

The Commission has consistently held that a carrier is to be declared dominant only if it possesses market power in the relevant product and geographic market.¹⁰⁷ Conversely, a carrier qualifies as non-dominant if it lacks market power in the relevant market.¹⁰⁸ In making a determination about whether a carrier has market power, the Commission analyzes whether the carrier has the ability to “raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or restrict output profitably.”¹⁰⁹

¹⁰⁴ Attachment C, Kahn and Tardiff Paper at 17.

¹⁰⁵ Id. For example, U S WEST’s rates for DS1 service fell by 43% from 1989 to 1998. Id.

¹⁰⁶ Id. at 17-18.

¹⁰⁷ AT&T Reclassification Order, 11 FCC Rcd. at 3346 ¶ 138.

¹⁰⁸ Id.

¹⁰⁹ Comsat Reclassification Order ¶ 67; see also In the Matter of The Merger of MCI Communications Corporation and British Telecommunications plc, Memorandum

Applying this standard to the evidence accumulated by U S WEST leads to the conclusion that U S WEST lacks the ability to exercise market power in the Phoenix area market for high capacity services. Following the approach the Commission previously used to assess market power for other services, Kahn and Tardiff conclude that the market for high capacity services in Phoenix “fully exhibits the indicia of competition that the Commission has prescribed.”¹¹⁰ In particular, Kahn and Tardiff rely on the following market characteristics: (1) U S WEST has a diminishing market share, serving only 30 percent of the retail market and providing barely half of the facilities that serve new demand; (2) customers (e.g., large businesses and other carriers) are highly sensitive to price and other service characteristics; (3) U S WEST’s competitors have the ability to expand their facilities and capture U S WEST’s existing business, and there are minimal barriers to entry; and (4) U S WEST’s size does not provide it an insurmountable advantage.¹¹¹ In light of U S WEST’s lack of market power, Kahn and Tardiff conclude that “competition itself, without dominant firm regulation, is sufficient to restrain [its] ability to impose anticompetitive prices and other conditions.”¹¹²

Opinion and Order, 12 FCC Rcd. 15351, 15398 ¶ 124 (1997); Bell Atlantic/NYNEX Order, 12 FCC Rcd. at 20038 ¶ 101.

¹¹⁰ Attachment C, Kahn and Tardiff Paper at 1.

¹¹¹ Id. at 20.

¹¹² Id. at 21.

III. FORBEARANCE FROM DOMINANT CARRIER REGULATION OF U S WEST IN THE PHOENIX MARKET FOR HIGH CAPACITY SERVICES IS WARRANTED

Section 10 of the 1996 Act requires that the Commission “forbear from applying any regulation or any provision of this [Act] to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets” if the Commission finds that:

- (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;¹¹³
- (2) enforcement of such regulation or provision is not necessary for the protection of consumers;¹¹⁴ and
- (3) forbearance from applying such provision or regulation is consistent with the public interest.¹¹⁵

In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.¹¹⁶

Based on the compelling economic evidence of the preceding section, U S WEST requests that the Commission forbear from regulating it as a dominant

¹¹³ 47 U.S.C. § 160(a)(1).

¹¹⁴ 47 U.S.C. § 160(a)(2).

¹¹⁵ 47 U.S.C. § 160(a)(3).

¹¹⁶ 47 U.S.C. § 160(b).

carrier in the Phoenix area market for high capacity services. In particular, U S WEST seeks forbearance from the following Commission regulations: (1) the requirement that incumbent LECs (but not providers other than incumbent LECs) must file tariffs for interstate access services;¹¹⁷ (2) Sections 61.38 and 61.41-61.49, which require dominant carriers to file tariffs on up to 15-days notice with cost support;¹¹⁸ (3) Section 69.3(e)(7), which requires averaged rates within a study area;¹¹⁹ (4) Sections 61.41-61.49, and 65, which impose price cap and rate of return regulation on dominant carriers;¹²⁰ and (5) any other rules that apply to U S WEST, but not other providers, in the Phoenix area market for high capacity services.

A. Dominant Carrier Regulation Of U S WEST's High Capacity Services In Phoenix Is Not Necessary To Ensure That Rates And Practices Are Just, Reasonable, And Not Unreasonably Discriminatory

The first statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in the Phoenix MSA is necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. As the Commission recognized, it is "highly unlikely" that carriers lacking market power could successfully charge rates that violate the Act, because an attempt to do so would

¹¹⁷ See CAP Forbearance Order, 12 FCC Rcd. at 8596 (forbearing from requiring non-incumbent LEC providers of exchange access services to file tariffs).

¹¹⁸ 47 C.F.R. §§ 61.38, 61.41-61.49.

¹¹⁹ 47 C.F.R. § 69.3(e)(7).

¹²⁰ 47 C.F.R. §§ 61.41-61.49, 47 C.F.R. § 65.

prompt customers to switch to different carriers.¹²¹ For that reason, the Commission has determined that tariffing is not necessary to ensure reasonable rates for carriers that lack market power.¹²² In this case, the market for high capacity services in the Phoenix MSA is sufficiently competitive that there is no reason to regulate any carrier as dominant.

In the preceding section, U S WEST demonstrated that it does not possess market power in the Phoenix area market for high capacity services. Therefore, it should not be required to file dominant carrier tariffs and comply with other dominant carrier regulations, such as the rate averaging requirement. Rather, as is the case for every other non-dominant carrier in the high capacity market, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.¹²³ Marketplace forces will effectively preclude U S WEST from charging unreasonable rates for high capacity services in the Phoenix MSA.

Moreover, other regulations are sufficient to ensure that U S WEST does not

¹²¹ PCIA Forbearance Order ¶ 57 (citing CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order, 11 FCC Rcd. 20730, 20742-47 ¶¶ 21-28 (1996) ("IXC Forbearance Order")).

¹²² CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; IXC Forbearance Order, 11 FCC Rcd. at 20742-43 ¶ 21.

¹²³ CAP Forbearance Order, 12 FCC Rcd. at 8610 ¶ 27. It should be noted that the Commission tentatively concluded that it should adopt mandatory detariffing for interstate exchange access services, as it previously adopted for interexchange services. Id. at 8613 ¶ 34.

attempt to charge unreasonable rates. In particular, Sections 201 and 202 of the Act require that rates and practices be just, reasonable, and not unreasonably discriminatory.¹²⁴ The Commission can address any issue of unlawful rates or practices through the exercise of its authority to investigate and adjudicate complaints under Section 208.¹²⁵ As the Commission recently noted, Sections 201 and 202 provide important safeguards for consumers in areas that have been deregulated by the Commission.¹²⁶ In those circumstances where the Commission has reclassified carriers as non-dominant because they lack market power and reduced those carriers' regulatory burden, the Commission has continued to require compliance with Sections 201 and 202.¹²⁷

It is also important to recognize that U S WEST is not seeking to impose restrictions on the resale of its high capacity facilities. The Commission has recognized that resellers exert downward pressure on rates through their ability to purchase service at high volume rates and pass through those savings to their customers.¹²⁸ In the Phoenix area market for high capacity services, where competitive providers already have captured 70 percent of the retail market segment, resellers clearly have the ability to exert such pressure. Thus, grant of U S WEST's Petition would not weaken the market forces that restrain U S WEST's

¹²⁴ 47 U.S.C. §§ 201(b), 202(a).

¹²⁵ 47 U.S.C. § 208(a).

¹²⁶ PCIA Forbearance Order ¶ 31.

¹²⁷ Id. ¶ 17.

¹²⁸ Id. ¶ 35.

ability to charge unreasonable rates.

B. Dominant Carrier Regulation Of U S WEST's Dedicated High Capacity Services In Phoenix Is Not Necessary To Protect Consumers

The second statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in Phoenix is necessary for the protection of consumers. As demonstrated in the previous section, dominant carrier regulation is not necessary to assure that U S WEST's rates and practices are just, reasonable and not unreasonably discriminatory. Because U S WEST lacks market power, rates for high capacity services will be effectively constrained by market forces. Further, the requirements of Sections 201 and 202 serve as an additional safeguard for consumers. Therefore, dominant carrier regulation of U S WEST also is not necessary to protect high capacity consumers from unreasonable rates or discriminatory practices. In fact, high capacity customers are being deprived of many of the benefits of competition in the Phoenix area market for high capacity services because of the continued regulation of U S WEST as a dominant carrier. Accordingly, the second criterion is satisfied.¹²⁹

C. Forbearance From Applying Dominant Carrier Regulation To U S WEST's High Capacity Services In Phoenix Is Consistent With The Public Interest

The third statutory criterion for forbearance requires that the Commission determine whether forbearance from applying dominant carrier regulation to U S WEST's high capacity services in the Phoenix MSA is consistent with the public

¹²⁹ Id. ¶ 58; CAP Forbearance Order, 12 FCC Rcd. at 8609-10 ¶ 26.

interest. In making this public interest determination, the Commission considers whether forbearance will “promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.”¹³⁰ Continuing to regulate U S WEST as a dominant carrier in the Phoenix area market for high capacity services results in competitive distortions that do not serve the public interest.

In the AT&T Reclassification Order, the Commission graphically described the significant social costs of continued asymmetrical regulation: (1) the longer tariff notices imposed on AT&T dampened its incentives to innovate because rivals could respond to innovations before they were allowed to go into effect; (2) the tariff filing requirements also dampened AT&T’s incentives to reduce prices; (3) AT&T’s competitors could use the asymmetrical regulatory process to delay and undermine its initiatives; and (4) regulation imposed administrative costs on both AT&T and the Commission.¹³¹

Kahn and Tardiff conclude that dominant carrier regulation of U S WEST in the Phoenix market for high capacity services market involves the same kinds of social costs.¹³² The 15-day tariff notice requirement, which applies only to U S WEST, gives competitive providers the opportunity to respond to U S WEST’s

¹³⁰ Comsat Reclassification Order ¶ 151; see also PCIA Forbearance Order ¶ 27.

¹³¹ Attachment C, Kahn and Tardiff Paper at 18 (citing AT&T Reclassification Order at ¶ 32); see also PCIA Forbearance Order at ¶ 30 (Forbearance with regard to broadband PCS carriers alone would create regulatory asymmetry with respect to cellular and other CMRS providers that would “distort competition and contradict the intent of Congress that CMRS providers should be treated similarly.”)

¹³² Attachment C, Kahn and Tardiff Paper at 18.

filed rate or be the first to market with a new service offering even before U S WEST's tariff becomes effective. Further, as a dominant carrier, U S WEST also is prohibited from responding to competition by charging deaveraged rates within the study area. If anything the social costs of dominant carrier regulation are compounded by the fact that U S WEST is prohibited from responding to competitive providers' bundled offerings, which may include interLATA voice and data services.¹³³

Moreover, continuing to regulate U S WEST as a dominant carrier in a competitive market results in "umbrella" pricing, where competitors argue that U S WEST's proposed tariff rates are unlawfully low while pricing their own services below U S WEST's tariffed rates. The Commission has recognized that requiring tariff filings may facilitate tacit collusion by enabling carriers to "ascertain competitors' prices and any changes to rates, which might encourage carriers to maintain rates at an artificially high level."¹³⁴ In comparison, forbearance of the tariff filing requirements "will foster competition which will expand the consumer benefits of a competitive marketplace."¹³⁵ Thus, dominant carrier regulation reduces the incentive of all competitors to initiate price reductions and new services, and adversely affects U S WEST's ability to respond

¹³³ Id. Kahn and Tardiff observe that, ironically, the incumbent LECs' Section 271 applications are being held-up pending demonstration that local markets are sufficiently open to competition. Id.

¹³⁴ Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services, Second Report and Order, 9 FCC Rcd. 1411, 1479-80 (1994).

¹³⁵ Id.

quickly and creatively to competition.

Dominant carrier regulation also imposes significant compliance costs on U S WEST and administrative costs on the Commission which are unnecessary in a competitive environment. The submission of detailed cost support with each tariff filing increases the cost of implementing new services and rate structures. These regulatory costs are passed through to high capacity consumers in the form of higher rates. Because U S WEST is the only competitor in the Phoenix area market for high capacity services that is forced to incur the regulatory costs associated with dominant carrier regulation, it suffers a unique competitive disadvantage. In comparison, permissive detariffing of these services “would reduce administrative burdens on [U S WEST] and on the Commission, promote competitive market conditions, facilitate provision of new service offerings, and promote market entry.”¹³⁶

The Kahn and Tardiff Paper addresses some of the broader public interest issues at stake in this proceeding. In order to ensure the continued development and modernization of the public switched telephone network and the availability sophisticated and innovative services – both of which are the central goals of the 1996 Act – all competitors, including incumbents, must be free from restrictions and handicaps on their ability to compete in the marketplace.¹³⁷ Moreover, all competitors must be given the “full, undiluted incentives of a free market system” to

¹³⁶ PCIA Forbearance Order ¶ 64 (comparing CAP Forbearance Order, 12 FCC Rcd. at 8610-12 ¶¶ 27-32).

¹³⁷ Attachment C, Kahn and Tardiff Paper at 18.

undertake the typically risky investments needed to drive innovation.¹³⁸

Kahn and Tardiff describe two types of free market incentives. The first type is the stimulus of competition itself.¹³⁹ The strongest case for substituting competition for regulation is the superior ability of the former to exert pressure on all competitors in the Phoenix area market for high capacity services to be efficient and innovative if they are to survive, let alone prosper.¹⁴⁰ Kahn and Tardiff identify two illustrations of this effect: (1) the wholesale adoption of hub and spoke operations and the development of computerized reservation systems by the airlines after their deregulation; and (2) the widespread adoption of just-in-time inventory systems made possible only by deregulation which gave truckers the freedom to enter into bidding contracts with penalties for failure to perform according to stipulated standards.¹⁴¹

The second type is the self-interest of competitors, freed from continuing restrictions on the services and innovations they are permitted to offer.¹⁴² In order to encourage innovation, competitors must be able to retain the profits from innovations that are successful, just as they are forced to bear the full cost of innovations that are failures. This symmetry can be achieved only through genuine

¹³⁸ Id.

¹³⁹ Id. at 19.

¹⁴⁰ Id.

¹⁴¹ Id.

¹⁴² Id.

deregulation.¹⁴³

As competition continues to develop in markets previously protected by regulation, the Commission should not weaken market-based incentives in a misguided effort to stimulate competition. Kahn and Tardiff point out that attempts to micromanage the process of deregulation, as has occurred in other industries, are more likely to produce distortions than to actually encourage efficient competition.¹⁴⁴ Ultimately, the Commission's incentive system should shrink regulatory restrictions to the absolute minimum and entrust protection of the public to a deregulated, competitive marketplace.¹⁴⁵

The Commission's own experience with AT&T and the long distance industry demonstrates the public interest benefits of a free market system. At the time, the Commission's decision to reclassify AT&T as non-dominant was strongly opposed by AT&T's competitors. However, the Commission recognized that allowing AT&T to compete on equal terms with its competitors would spur increased competition in the long distance market. AT&T has continued to lose market share since it was declared non-dominant in 1995 while its competitors have thrived, indicating that the reclassification has not harmed competition.¹⁴⁶ Likewise, symmetrical regulation of U S WEST and competitive providers as non-dominant carriers would serve the public interest by promoting competitive market conditions and

¹⁴³ Id.

¹⁴⁴ Id.

¹⁴⁵ Id. at 19-20.

¹⁴⁶ Attachment C, Kahn and Tardiff Paper at 20.

facilitating the introduction of new service offerings, service enhancements, and price reductions.

IV. REGULATING U S WEST AS A NON-DOMINANT CARRIER IN THE PROVISION OF HIGH CAPACITY SERVICES IN PHOENIX IS NOT TOTAL DEREGULATION

U S WEST is not requesting that its high capacity services be totally deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the Phoenix area market for high capacity services. As discussed above, like other non-dominant carriers, U S WEST will still be subject to regulation under Title II of the Communications Act of 1934, as amended. For example, non-dominant carriers are required to offer interstate services under rates, terms and conditions that are just, reasonable and not unduly discriminatory.¹⁴⁷ In addition, non-dominant carriers are subject to the Commission's complaint process.¹⁴⁸ At this time, non-dominant carriers are also required to give notice prior to discontinuance, reduction or impairment of service.¹⁴⁹

As a non-dominant carrier, however, U S WEST would enjoy streamlined regulation equal to that of all its competitors in the Phoenix area market for high capacity services. First, U S WEST would be subject to permissive detariffing, which would allow, but not require, the filing of tariffs for interstate high capacity services on one-day's notice with a presumption of lawfulness and without any cost

¹⁴⁷ 47 U.S.C. §§ 201(b), 202(a).

¹⁴⁸ 47 U.S.C. §§ 208(a).

¹⁴⁹ 47 U.S.C. § 214.